

# FINANCIAL PLAN

The four-year financial plan is a critical tool for ensuring the long-term fiscal health of the District. Recently, District leaders set out three key goals relevant to this plan – all of which have been met or will most likely be met at the outset of FY 2001:

Goal	Status
Eliminate the accumulated deficit through budget surpluses.	Recent budget surpluses have completely eliminated the accumulated deficit. Most importantly, this was accomplished through achieving annual operating surpluses, not through additional borrowing.
Establish a positive fund balance equal to 5 percent of the gross operating budget.	Surpluses since FY 1997 have resulted in a positive fund balance. Preliminary results indicate that FY 1999 closed with another surplus.
Achieve structural balance by aligning the growth rates of revenues and expenditures.	The financial plan shows that the average growth of revenues matches that of expenditures over the course of the financial plan.

These results show that the District continues to improve its financial health. Going forward, however, the District must continue to show progress related to these goals for several reasons:

- **Home rule.** The control period will end only when the District regains Wall Street's confidence and achieves balanced budgets for four consecutive years (FY 2000 will be the fourth consecutive year to show a balanced budget).
- **Bond ratings.** Structural balance and a 5 percent positive fund balance greatly enhance the District's prospects for earning investment grade bond ratings.
- **Capital investment.** The District must develop adequate financial reserves and borrowing capacity to support the financing of badly needed investment in capital infrastructure.
- **Tax relief.** Careful control of expenditures will allow the District to successfully implement tax relief.

The FY 2001 Budget and Financial Plan effectively balances the tradeoffs inherent in serving these interests. In this chapter, the following items will be presented:

- Financial plan overview
- Assessment of fiscal health
- Summary of revenue projections
- Summary of expenditure projections
- The bottom line

These issues will be discussed in turn, beginning with the overview.

## FINANCIAL PLAN OVERVIEW

The financial plan reflects the general fund resources necessary to fulfill the District's policy agenda. The purpose of this section is to present the financial plan and describe each item within, and highlight key budget issues. Of special note, the FY 2001 Budget and Financial Plan includes the following major items:

- **Tax Reduction.** The revenue projections in the financial plan reflect the second year impact of a major tax reduction that was begun in FY 2000 and will be implemented over the next four years. The reduction includes taxes on individual income, personal property, franchises, and other areas in an effort to stimulate economic development and bring the District's tax structure in line with those of neighboring jurisdictions.
- **Reserve.** As in FY 2000, the Congress has required that the District annually budget a \$150 million operating reserve, and maintain a \$250 million fund balance. Although this requirement has substantially constrained the District's ability to fund new initiatives, the financial plan reflects compliance with both of these requirements.
- **Savings.** The District has begun a new era of accountability and reform, and as such has committed to producing dramatic improvements in service delivery and in cost efficiency. The efficiencies achieved are projected to produce \$62 million in savings in FY 2001 and approximately \$60 million each year thereafter.

This discussion will now specifically review the financial plan, presented on the following page.



## Gross Funds

It is important to note that this plan reflects gross expenditures (i.e., the total of local, federal, private, and other expenditures), although only local revenue and expenditures contribute to the annual surpluses/deficits and the fund balances. Each item in the plan is described below. The row numbers and headings presented below correspond to those in the financial plan.

1. Taxes. Includes property, sales, income, and other taxes, which are projected by the Office of Tax and Revenue and certified by the District of Columbia Financial Responsibility and Management Assistance Authority (DCFRMAA). Beginning in FY 2000, revenues reflect a five-year tax reduction that was implemented in FY 2000. See the *Revenues* chapter for further details.
2. Non-tax revenue. Includes revenue from licenses and permits, parking and traffic fines, charges for services, interest income, and other revenue sources. Non-tax revenues include 30 percent of the tobacco settlement in FY 2000 and FY 2001. See the *Revenues* chapter for further details.
3. Federal payment contribution. Reflects the funding contributed by the federal government. The payments provided by the federal government in FY 2000 and FY 2001 is accounted for as local funds.
4. Lottery. Reflects revenues from the District's lottery.
5. Subtotal Local Funds. Provides a summation of the revenues from local sources.
6. Grants. Federal grant awards anticipated by District agencies.
7. Federal Payments. Reflects federal appropriations targeted for specific uses. The payment provided for in FY 1999 is accounted for as non-local funding.
8. Private/Other revenues. Includes revenues from service charges and user fees that are collected and spent by the collecting agency. This pool is distinct from the Non-Tax Revenue category above, which is utilized in the general pool of discretionary local revenue.
9. Subtotal Non-Local Funds. Provides a summation of the non-local funding sources presented immediately above.
10. Total Revenues. Provides a summation of the revenue subtotals above.
11. Agency Expenditures. These items reflect agency expenditures by appropriation title. The growth of expenditures in the out-years is based on certain growth assumptions that are discussed later in this chapter.
12. Financing and Other. Includes Repayment of Loans and Interest, Repayment of General Fund Deficit, Short-Term Borrowings, and Certificate of Participation. In addition, this line includes Optical and Dental Insurance Premiums, Productivity Bank and Productivity Bank Savings for FY 2001-2004.
13. Financial Authority. Reflects the appropriation for the District of Columbia Financial Responsibility and Management Assistance Authority.
14. Local fund support for Enterprise funds. Reflects local funds provided for Enterprise funds in order to reconcile with other presentations of data in FY 1999.
15. Non-Union Pay Increase. Reflects the pay increase to be received by all non-union District employees in FY 2000.
16. Optical and Dental Benefits. Reflects the cost of extending FY 2000 of optical and dental benefits to nonunion employees during FY 2000. The cost of these benefits in FY 2001 and afterward is included on in the Financing and Other appropriation title above.
17. Reserve. Reflects the \$150 million reserve mandated by Congress.

18. Productivity Bank. The Productivity Bank is intended to be a revolving fund that will enable the District of Columbia to finance projects that decrease the cost of delivering municipal services or increase revenues to the District. These costs are for FY 2000. Costs in FY 2001 and onward are included in the Financing and Other appropriation title above.
19. Productivity Bank Savings. Savings intended to be achieved through use of Productivity Bank. These savings are for FY 2000. Savings in FY 2001 and onward are included in the Financing and Other appropriation title above.
20. Management Reform Productivity Savings. Reflects In FY 1999, the consensus budget included savings due to management reform in the amount of \$10 million in FY 1999, with an additional \$10 million to be achieved in each of the out-years. These targets are reflected here. In addition, \$7 million was added for FY 2000 onward. Additional savings are targeted in FY 2002 – FY 2004.
21. Managed Competition. Reflects funding in FY 2000 for severance payments, expanded contracting and procurement authority, and managed competition.
22. Operational Improvement Savings. Reflects the savings projected to result from the use of a variety of tools that can be used in appropriate situations to achieve service improvements, efficiencies and cost savings.
23. Management Supervisory Service (MSS). Reflects funding for an approximately 19 percent pay increase to certain managers/supervisors that will be transferred to this new classification.
24. General Supply Schedule Savings. Reflects savings in FY 2000 as a result of an initiative to employ a general supply schedule.
25. Risk Management. The new Office of Risk Management expects to generate \$15 million in savings through reductions in the District's exposure to risk liabilities.
26. Total Expenditures. This item provides a summation of all expenditures and savings presented above.
27. Total – Budget Basis. This item shows the difference between total revenues and total expenditures. This is presented on a budgetary basis, which means that GAAP accounting adjustments are not reflected.
28. Prepayment of Debt Service. Reflects the dedication of \$30 million in FY 1999 to prepay debt service for FY 2002 and 2003.
29. Net Benefit from ITS. Reflects the increased revenues expected from implementation of the new Integrated Tax System by the Office of Tax and Revenue.
30. Revised Total – Budget Basis. Reflects the positive impact of the debt service prepayment and the net benefit from ITS on each annual surplus.
31. Estimated GAAP Reconciliation.
32. Total (Estimated) Surplus – GAAP Basis.
33. Fund Balance (Beginning of year). Shows the accumulated fund balance for the general fund at the beginning of the fiscal year, which is identical to the end of year fund balance for the previous fiscal year.
34. Fund Balance (End of year). Shows a summation of the beginning of the year fund balance and the annual surplus.



Having thereby established an overview and description of the local and gross versions of the financial plan, the next section provides an assessment of this plan's impact on the financial health of the District.

## ASSESSMENT OF FISCAL HEALTH

To receive a clean bill of financial health, a financial plan must meet at least three conditions:

- Revenues meet or exceed expenditures in the current year
- Revenues grow at the same rate or higher as expenditures in future years.
- Each year shows a positive fund balance of at least 5 percent of the gross operating budget.

The *FY 2001 Proposed Budget and Financial Plan* meets all three of these conditions. To satisfy the first condition, this plan includes a budgeted surplus of \$511,000 for FY 2001. Under normal circumstances this surplus may appear unreasonably small, but one must remember that the District has budgeted a full \$150 million reserve to protect against revenue shortfalls or unanticipated expenditures.

With regard to the second condition, both gross revenues and gross expenditures are growing at an average rate of 2.6 percent. This demonstrates that the District's budget is structurally balanced. Figure 1 provides a magnified view of the growth of revenues and expenditures.

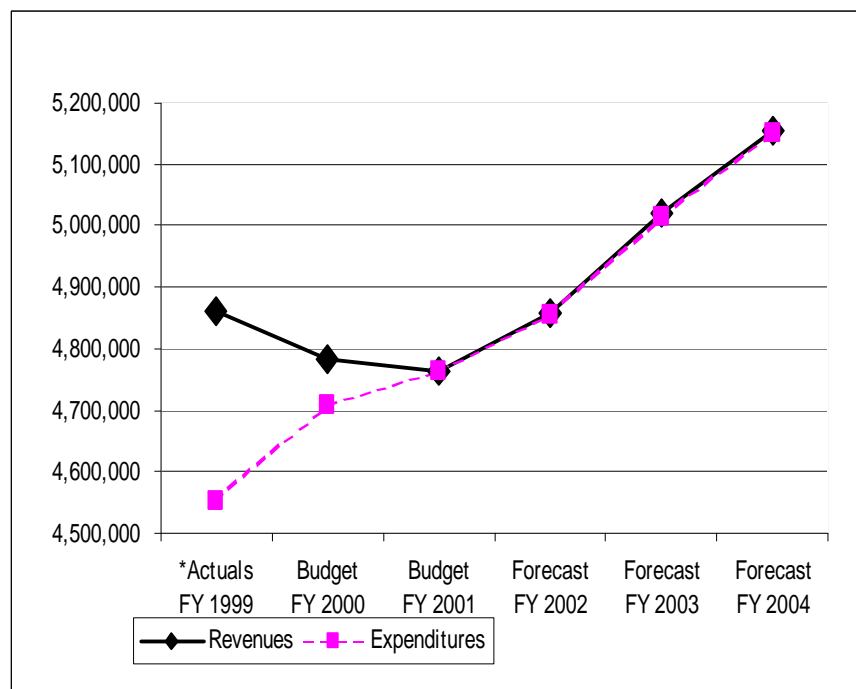
**Figure 1**

### Structural Balance is achieved in the Financial Plan

#### Revenue and Expenditure Trends FY 1999 - FY 2004

Gross Funds

\*FY 1999 Actuals unaudited



For both revenues and expenditures, these growth rates are composites of smaller items that grow at varying rates. Subsequent sections of this chapter provide greater detail on the specific components that produce these aggregate rates.

Finally, this financial plan shows a positive fund balance in excess of the 5 percent target of approximately \$244 million. The projected FY 2001 fund balance totaling \$292 million provides the District with substantial protection against potential economic downturns or unanticipated expenditures.

In sum, the FY 2001 Budget and Financial Plan effectively balances the need to invest in service delivery while guarding the financial health of the District. The following sections summarize the basis for the revenue and expenditure projections included in the financial plan.

## SUMMARY OF REVENUE PROJECTIONS

The outlook for FY 2000 through FY 2004 is positive with real growth in gross state product and personal income forecasted for the District's economy. This outlook, nonetheless, is cautious with only modest improvements in any economic category. The District is vulnerable to national economic changes such as rising interest rates that affect consumer spending for travel, automobiles, housing, and other "big ticket" items. Regionally, as the District economy becomes more competitive it also will face stronger challenges from neighboring rivals. And locally, the recovery of the District's public service delivery is critical to sustaining economic development. These are all in the mix of considerations that shape the short- and long-term revenue projections. This chapter discusses the District's revenue sources, its economy, and the outlook for revenue through FY 2004.

The FY 2001 budget, which is balanced with no tax increases envisioned, is the fourth budget prepared following the congressional enactment of the District of Columbia Revitalization Act of 1997. This legislation directed the Federal government to assume responsibility for several major items previously included in the District's budget (principally past pension liabilities, courts and corrections, and additional Medicaid funding) in return for termination of the annual Federal payment which had supplemented local revenue for over a century.

Total local-source general fund revenue for FY 2001 is estimated to be \$3,195,979,000 while local source revenue for FY 2000 is now expected to be \$3,211,752,000. Local-source, general fund revenue consists of local taxes, user fees, the lottery and federal payments for scholarship and adoption programs. They do not include grant revenue or revenue earmarked for specific uses, which are accounted for in special funds. The 0.05 percent reduction in estimated revenue is primarily the result of the tax rate reductions contained in the Tax Parity Act of 1999. These revenue estimates mirror the cautious optimism theme about the economy of the District.

The District's economy faltered in the last decade, with plummeting population and employment, vacant office space and housing, declining property values, and generally a loss of hope in its economic fortunes. A booming national economy brought opportunity to the District and the nation. At the same time, new leadership approximately 2 years ago rekindled faith in the District as a place to live, to work, and to earn a positive return on investment. Accordingly, District is beginning to recover. So far, the recovery is small and fragile, and its benefits are not evenly distributed across the District. The areas of strength in the economy are only weakly connected to the District's tax base, implying that even with economic growth the District may have trouble meeting its revenue needs over the long-term.

## SHORT TERM ECONOMIC OUTLOOK (FY 2000 - FY 2001)

The national forecast is for positive real growth in GDP but lower than the average growth for 1998 and 1999. At the beginning of the period, unemployment and inflation are quite low,<sup>1</sup> with interest rates rising slightly.

The outlook for the Washington Metropolitan Regional Economy is favorable and consistent with national trends. In December 1999, Stephen S. Fuller, a George Mason University economist, observed

<sup>1</sup> The Congressional Budget Office (CBO), the Office of Management and Budget (OMB) and the consensus Blue Chip forecast.



that calendar year 1999 ended with the Washington Coincident Index<sup>2</sup> and the Leading Index<sup>3</sup> both registering positive performances for the 4<sup>th</sup> quarter. However, the region's current rate of growth no longer exceeds its rate of a year ago and may be poised to slowly change direction in the coming months. Standard and Poor's DRI anticipates that growth in the Washington Metropolitan Region will change with the national economy.

Against the backdrop of a strong national and regional economy, the District of Columbia economy is forecast to show steady growth in FY 2000 and FY 2001, with increases in jobs and in employment of the District residents. Inflation-adjusted gross state product (GSP) and personal income are forecast to increase at average annual rates of 1.0 percent and 2.6 percent respectively. Activities currently underway that will boost the economy include new retail and restaurant development associated with the MCI Center, the transfer of jobs to the D. C. Navy Yard, and construction of the new Convention Center.

### LONG-TERM ECONOMIC OUTLOOK (FY 2002 - FY 2004)

In looking further ahead to FY 2002 through FY 2004, the key economic issues are how much the national economy can continue to expand and the extent to which improving public services will stimulate economic development in the District. Nationally, the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and the Blue Chip consensus all anticipate moderate growth from 2002 to 2004. DRI also forecasts growth in the Washington metropolitan region to continue at approximately the same rate of the nation as whole, although factors such as traffic congestion and the shortage of skilled labor for technology-oriented industries could restrain this growth.

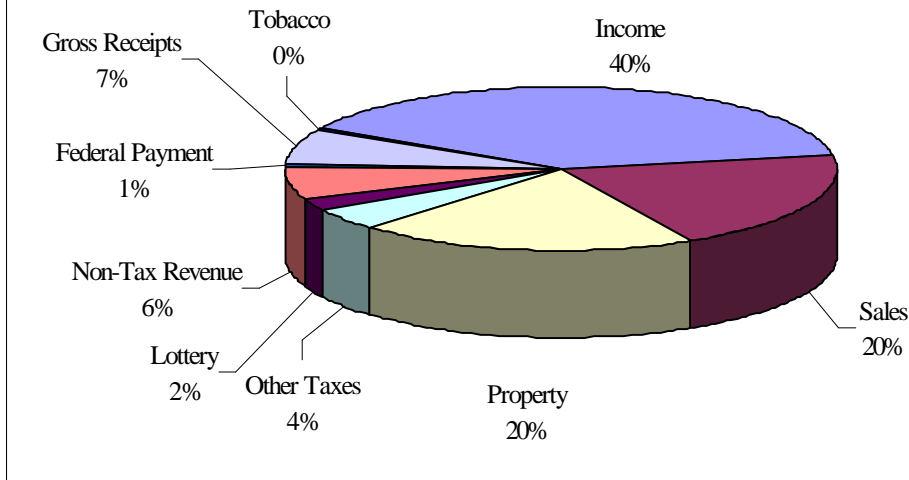
Led by the service sector, jobs in the District are assumed to increase by 5,000 positions during the FY 2002 to FY 2004 period. Resident employment is expected to increase by 2,000 and inflation-adjusted gross state product and personal income are expected to increase at average annual rates of 0.6 percent and 1.7 percent respectively. Growth in retail sales and housing starts are also expected and an end to the decline in the District population is anticipated. In the hospitality sector of the economy, sales are expected to rise during the 2001 Inauguration and again when the new convention center opens in 2003.

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<sup>2</sup> The Washington Coincident Index is derived from changes in wage and salary employment, consumer confidence, nondurable goods retail sales, and passenger boardings at National Airport.

<sup>3</sup> The Washington Leading Index is derived from durable goods sales, residential building permits, consumer expectations, initial unemployment claims in the District of Columbia, and the help-wanted index. See Stephen S. Fuller, Economic Forecast, February 6, 1998, Washington Post.com.

### Estimated General Fund Revenue in FY 2001



### REVENUE IN FY 2000 THROUGH FY 2004

General fund revenue to finance operating fund expenditures for FY 2001 is estimated to be \$3,195,979, which is \$15.7 million less than the FY 2000 revised estimate of \$3,211,752 by \$15.7 million. In FY 2001, non-general fund estimated revenue are as follows: Arena Fee collections, \$9 million; Convention Center revenue, \$54.8 million; and the Motor Fuel Tax for the Highway Trust fund, \$32.2 million. Water and Sewer Authority revenue is estimated at \$248.2 million.

Conflicting considerations enter into the revenue estimate. The District's control period will end during FY 2001 only if the budgets are balanced in FY 1999 and FY 2000 and the financial statements are deemed by independent auditors to fairly represent the District's financial position. Many new service delivery mechanisms of the District have not yet been developed, as such their impact on the economy and on revenue can not be predicted. These factors mitigate in favor of conservative revenue estimates to protect the long-term goal of full home-rule. On the contrary, the District has critical human service, public works, public safety, education, and other needs that press for budgets based on more generous estimates.

### Factors Underlying Current Revenue Estimates

As discussed above, the outlook for the forecasting period, FY2000 through FY2004, is positive for the District's economy with real growth in gross state product and personal income. This outlook, nonetheless, is cautious with only modest improvements in any economic category. The economic signs are positive for the District with a continued strength in high-end office space and in the demand for single-family housing. The expected turn-around in population growth could occur even earlier than FY2004 with only a small shift in net migration. Continued consumer confidence will help sustain sales tax revenue. Even a moderate slow-down in financial market activity would probably not directly affect taxable capital gains for 18 to 24 months.

The District, as with all jurisdictions, is vulnerable to national economic changes such as rising interest rates that affect consumer spending for travel, automobiles, housing, and other "big ticket" items. Regionally, as the District economy becomes more competitive it also will face stronger challenges from

neighboring rivals. Locally, the recovery of the District's public service delivery is critical to sustaining economic development. These are all of considerations that shape long-term revenue projections.

Finally, the activity to re-engineer the government of the District is influencing the revenue stream. Specifically, the District has made multiple decisions to reduce tax rates, change tax bases, and improve the tax structure. Between FY 1998 and FY 2001 the estimated impact of these changes is expected to reduce FY 2001 tax revenue by \$175 million. Ongoing implementation of the Tax Parity Act of 1999 will incrementally reduce revenue each year until fully implemented in FY 2004. Policy changes to non-tax local revenue include: 1) dedicating funds to specific uses -- such as support for the Public Service Commission to facilitate their self-sufficiency; and 2) implementing new programs such as the right-of-way fee and the red-light camera project. These yield a net reduction in general fund revenue of \$11 million in FY 2001 as compared to the FY 1998 base.

The long-term projections show 1.7 percent growth in General Fund revenue in FY 2002, 3.3 percent in FY 2003, and 2.2 percent in FY 2004. These changes, which do not include any Tobacco Settlement funds, are adjusted for all policy decisions including the rolled-in tax law changes under the Tax Parity Act.

The following table sets forth the economic assumptions used in the revenue estimates.

## Economic Assumptions Underlying the Forecast

The District Economy: Key Variables for the Forecast Period: FY 1996 to FY 2004									
(Fiscal Years)	1996 actual	1997 actual	1998 actual	1999 est	2000 est	2001 est	2002 est	2003 est	2004 est
Gross State Product (\$ billion)	50.10 2.0%	51.84 3.5%	53.54 3.3%	55.13 3.0%	56.94 3.3%	58.98 3.6%	61.05 3.5%	63.23 3.6%	65.50 3.6%
Real Gross State Product (billions of \$92)	44.13 -1.4%	44.08 -0.1%	44.22 0.3%	44.49 0.6%	44.91 0.9%	45.35 1.0%	45.65 0.7%	45.89 0.5%	46.13 0.5%
Personal Income (\$ billion)	18.28 2.5%	18.84 3.0%	19.34 2.7%	20.15 4.2%	21.02 4.3%	21.94 4.4%	22.84 4.1%	23.77 4.1%	24.74 4.1%
Real Personal Income (billions of \$92)	16.80 0.7%	17.00 1.1%	17.28 1.6%	17.76 2.8%	18.20 3.3%	18.69 2.7%	19.05 2.0%	19.36 1.6%	19.67 1.6%
Per Capita Income (\$)	33,766 5.0%	35,456 5.0%	36,911 4.1%	38,832 5.2%	40,798 5.1%	42,847 5.0%	44,707 4.3%	46,506 4.0%	48,325 3.9%
Real Per Capita Income (\$92)	31,039 2.9%	31,991 3.1%	32,965 3.0%	34,220 3.8%	35,698 4.3%	37,106 3.9%	38,089 2.6%	38,965 2.3%	39,906 2.4%
Population ('000)	541.5 -2.3%	531.3 -2.0%	524.1 -1.1%	519.0 -1.0%	515.1 -0.8%	512.0 -0.6%	510.9 -0.2%	511.1 0.0%	512.0 0.2%
Households ('000)	231.8 -1.5%	228.8 -1.3%	228.0 -0.3%	228.5 0.2%	229.1 0.3%	230.0 0.4%	232.6 1.1%	234.8 0.9%	237.9 1.3%
Civilian Labor Force ('000)	274.4 -4.6%	259.5 -5.4%	266.1 -2.5%	269.9 1.4%	273.3 1.3%	274.3 0.4%	276.0 0.6%	276.9 0.3%	278.2 0.5%
At-Place Employment ('000)	627.5 -2.8%	619.0 -1.4%	615.7 -0.5%	616.3 0.1%	618.4 0.3%	621.5 0.5%	623.2 0.3%	624.7 0.2%	626.7 0.3%
Resident employment ('000)	250.4 -4.6%	239.4 -4.4%	242.2 1.2%	250.9 3.6%	257.4 2.6%	258.6 0.5%	259.3 0.3%	259.9 0.2%	260.7 0.3%
Unemployment Rate	8.8%	7.7%	9.0%	7.0%	5.8%	5.7%	6.0%	6.1%	6.3%
Housing Stock Total	273.5 -0.9%	271.1 -0.9%	269.4 -0.6%	267.9 -0.6%	265.9 -0.7%	263.5 -0.9%	261.1 -0.9%	258.7 -0.9%	256.4 -0.9%
Retail Trade Sales (\$ billion)	3.39 -7.3%	3.47 2.3%	3.61 4.2%	3.85 6.5%	4.02 4.5%	4.15 3.2%	4.27 3.1%	4.43 3.7%	4.62 4.2%
Retail Trade Sales (\$1992 billion)	3.27 -8.0%	3.32 1.7%	3.44 3.6%	3.64 5.7%	3.78 3.9%	3.89 2.8%	3.99 2.7%	4.12 3.2%	4.27 3.7%
Washington Area Consumer Price Change	+2.7%	+2.4%	+1.1%	+2.0%	+2.6%	+2.2%	+2.6%	+2.8%	2.9%

Source: OTR based on Standard and Poor's DRI and RFA 11/99 forecasts for the District of Columbia..

Against a background of low inflation and continued growth in the national and Metropolitan Washington regional economies, the FY 2001 Budget and Financial Plan assumes that the District's economy will continue to grow throughout the period. Increases of several thousand jobs are anticipated each year through FY 2004, and the rate of nominal personal income growth in the District is expected to be 80 percent to 90 percent of the national growth rate.

## Forecasting Risks

As with any predictions of the future, these will be in error; our goal is to minimize the extent of the error. Small risks include deviations from the forecast rate of increase in GSP and Personal Income – a 1 percent error in each would adjust the estimates by approximately \$20 million from income and sales taxes. A sustained recession or robust growth would have a major impact on these estimates. A recession that begins immediately and deepens for several months could reduce FY 2001 revenue by a substantial amount; however, no recession is forecast at this time. Alternatively, if the local economy and income grow 2 percent more than forecast and financial markets continue strong growth, revenue could be above the estimates. Finally, the level of voluntary compliance and the possibility of uncollectable receivables both have significant potential to alter revenue either favorably or adversely.

Having discussed the revenue side of the financial plan, this chapter now turns to a discussion of expenditures.

### SUMMARY OF EXPENDITURE PROJECTIONS

Expenditure projections in the financial plan are computed through a detailed series of spending projections that are applied to categories of FY 2001 spending. The purpose of this section is to present and explain the methods used to compute future year expenditures, and to discuss how they interact to create aggregate growth rates.

There are four main methods used to project future expenditures. These methods are grouped into two categories: regular expenditures and unique expenditures. Regular expenditures represent the anticipated growth of agency expenditures as needed to maintain current service levels. In the Financial Plan, these expenditures are reflected on lines 11 through 17 of the financial plan for gross funds above.

Unique Expenditures represent those expenditures that do not grow consistently or have not been incorporated into agency spending projections. These expenditures consist of the items in lines 21 through 31 of the financial plan. For each of these expenditure types, the Financial Plan uses different projection methods:

- Regular Expenditures
  - © Growth rates by object class
  - © Growth rates by program/agency
- Unique Expenditures
  - © Computed annual expenditures
  - © Growth for unallocated items

Each of these methods are described below, and specific descriptions of their applications are provided.

#### **Regular Expenditures: Growth Rates by Object Class**

The use of growth rates by object class serves as the primary method for computing future year expenditures, and accounts for roughly 80 percent of all projections. The other methods simply provide for exceptions where these rates do not apply.

This method assigns a specific growth rate for each spending category (object class) of an agency's budget. Sometimes this rate applies equally to all three future years, and other times it is adjusted to account for differences from year to year. The following sections describe the specific rates used by object class.

### ***Personal Services***

A personal services growth rate of 4.3 percent is used for all future years, and is composed of two parts. First, an estimate of 1.8 percent growth accounts for step increases. Second, an estimate of 2.5 percent growth reflects potential adjustments in compensation such as cost-of-living adjustments (COLA). This estimate is based on an average of COLAs provided to employees in recent years in the Surrounding Metropolitan Statistical Area (SMSA). This 4.3 percent was applied to all object classes associated with personal services, as indicated below.

Code	Object Class	FY 2002	FY 2003	FY 2004
11	Regular Pay –Cont. Full Time	4.30%	4.30%	4.30%
12	Regular Pay – Other	4.30%	4.30%	4.30%
13	Additional Gross Pay	4.30%	4.30%	4.30%
14	Fringe Benefits - Curr. Personnel	4.30%	4.30%	4.30%

### ***Non-Personal Services***

Non-personal services are projected to grow at the rate of growth of the consumer price index for the District of Columbia as projected by DRI-McGraw Hill. The index accounts for the general inflation of goods and services specific to this region. This rate does not account for savings projected under the District's planned use of a general supply schedule or other cost savings initiatives.

Code	Object Class	FY 2002	FY 2003	FY 2004
20	Supplies and Materials	2.60%	2.80%	2.90%
40	Other Services and Charges	2.60%	2.80%	2.90%
41	Contractual Services - Other	2.60%	2.80%	2.90%
50	Subsidies and Transfers	2.60%	2.80%	2.90%
60	Land and Buildings	2.60%	2.80%	2.90%
70	Equipment and Equipment Rental	2.80%	2.80%	2.90%

### ***Energy***

The Office of Property Management's Energy Management Division estimates that utility costs will likely decrease based upon cost reduction strategies presently being implemented. In FY 1998, energy costs decreased by 13.7 percent from the prior year. This decrease was attributed to the removal of the Water and Sewer Authority from energy totals and warm weather. In FY 1999, energy costs decreased 14.7 percent from FY 1998. In addition, this decrease was also the result of warm weather.

FY 1999 energy costs totaled \$47.5 million. This total includes natural gas, electricity, fuel oil and steam costs. Based on the CPI and U.S. Department of Labor, Bureau of Labor Statistics for inflation, the EMD assumed a 3 percent inflation rate for FY 1999.

Code	Object Class	FY 2002	FY 2003	FY 2004
30	Utilities (Energy)	2.60%	2.80%	2.90%

### ***Telecommunications***

Telecommunication costs have been steadily rising over the last ten years. Expenditures for FY 1997 increased by over 40 percent compared to FY 1996. This dramatic increase is attributable to the purchase and replacement of telephone systems that was counted as a telecommunications expenditure. This one-

time expense distorts the trend for telecommunications costs. As a result, the FY 1997 data was adjusted by removing the out-year expenditure in order to attain a more accurate projection. Based on this adjusted trend forecast, telecommunications expenditures are expected to grow at a rate of about 2.6 percent over the course of the financial plan.

Code	Object Class	FY 2002	FY 2003	FY 2004
31	Telephone, Telegraph, Telegram	2.60%	2.60%	2.60%

### ***Rent***

The Office of Property Management projects that rent expenditures are expected to increase at a rate of 3 percent annually over the course of the financial plan. This rate is based on the Washington CPIU and the CPIW, both adjusted and unadjusted, and assumes that these indices will remain steady.

Code	Object Class	FY 2002	FY 2003	FY 2004
32	Rentals - Land and Structures	3.00%	3.00%	3.00%

### **Regular Expenditures: Growth Rates by Program/Agency**

This method applies to programs/agencies that do not grow according to the assumptions defined above. Instead, there are unique growth rates that are applied to them, regardless of spending category. For the current financial plan, the following items receive this treatment.

#### ***Medicaid***

Medicaid is an entitlement program that provides health care insurance and other services to low-income individuals. Because it is an entitlement program, the District must budget enough funds to cover expected expenditures. Over the course of the financial plan, Medicaid is expected to grow by approximately 4 percent.

Agency/Program	FY 2002	FY 2003	FY 2004
Medicaid	4.0%	4.0%	4.0%

#### ***Public Schools***

FY 2001 marked the first year that the D.C. Public Schools and Public Charter Schools receive funding based on a per-pupil funding formula. The provisions of this formula are statutorily defined, and one such provision dictates that once the base formula is established, future budget allocations should increase based on the rate of inflation for the prior year. As such, school funding is projected to grow at the rate of inflation for the prior year.

Agency/Program	FY 2002	FY 2003	FY 2004
Public Schools (Local Funds Only)	2.20%	2.60%	2.80%

### ***D.C. Retirement Programs for Police/Firefighters and Teachers***

The District costs associated with retirement programs for police/firefighters and teachers changed dramatically in FY 1998 due to the passage of the District of Columbia Retirement Protection Act of 1997. This Act transferred most of the liabilities accrued as of June 30, 1997, as well as approximately \$3.5 billion in assets to the Federal government. As a result, the District has been relieved of its responsibility to fund the costs associated with this unfunded liability, which was \$4.8 billion as of October 1, 1996.

The District's pension contribution beginning in FY 2001 is projected to account for a normal contribution rate to the projected payroll for firefighters/police and teachers. The normal contribution rate is consistent in the out-years, so the growth rates use simply reflect inflation.

Budget Item	FY 2002	FY 2003	FY 2004
Police and Fire Retirement	2.60%	2.80%	2.90%
Teacher's Retirement Fund	2.60%	2.80%	2.90%

### ***Washington Metro Area Transit Authority Subsidy***

The Washington Metro Area Transit Authority subsidy is projected to grow at a rate of 4 percent per year over the course of the financial plan. Higher than inflationary growth is projected as new Metrorail and bus service comes online. In addition, new labor agreements will be negotiated, and the provisions of certain federal laws will be implemented. Laws such as the Americans with Disabilities Act, the Clean Air Act Amendments, and the Intermodal Surface Transportation Efficiency Act will impact the District's subsidy requirement.

Budget Item	FY 2002	FY 2003	FY 2004
Mass Transit Subsidies	4.00%	4.00%	4.00%

### **Unique Expenditures: Computed Annual Expenditures**

For certain other items, future expenditures are not projected using simple growth rates. Instead, the Financial Plan reflects their future year expenditures as computed through unique computations for each year. These items are described below.

### ***Debt Service***

Debt service estimates are calculated based on the anticipated short and long-term borrowing needs of the District. The general obligation bond debt service estimates are based on a planned debt restructuring that will yield over \$50 million in savings in each year of the financial plan.

Budget Item	FY 2002	FY 2003	FY 2004
Repayment of Loans and Interest	329,109,418	355,891,714	364,655,203
Repayment of General Fund Deficit	39,143,111	39,165,974	0
Short-Term Borrowings	4,500,000	4,500,000	4,500,000
Certificate of Participation	7,950,000	7,950,000	7,950,000



### Unique Expenditures: Growth for Unallocated Items

Finally, the financial plan includes projections for items that will eventually be allocated to agencies, but at present remain unallocated. These items are treated according to the unique nature of each, as described below.

#### *Management Supervisory Service*

This item reflects personal service costs associated with the transfer of certain managers and supervisors to a new job classification. The growth rate for this item is 4.3 percent, the same rate used for all personal service expenditures.

Unallocated Item	FY 2002	FY 2003	FY 2004
Management Supervisory Service (MSS)	4.3%	4.3%	4.3%

#### *Reserve*

The Congress requires that the District budget a \$150 million reserve each year. As such, no growth is required for this item.

Unallocated Item	FY 2002	FY 2003	FY 2004
Reserve	\$150,000	\$150,000	\$150,000

#### *Risk Management*

The new Office of Risk Management (ORM) expects to generate \$15 million in savings in FY 2001. These savings reflect reductions in the District's exposure to risk liabilities.

Unallocated Item	FY 2002	FY 2003	FY 2004
Risk Management	(\$15,000)	(\$15,000)	(\$15,000)

#### *Management Reform Productivity Savings*

In FY 1999, the consensus budget included savings due to management reform in the amount of \$10 million in FY 1999, with an additional \$10 million to be achieved in each of the out-years. These targets are reflected here. In addition, \$7 million was added for FY 2000 onward. In FY 2001, savings totaling \$37 million are projected to be achieved from management reform.

Unallocated Item	FY 2002	FY 2003	FY 2004
Management Reform Productivity Savings	(\$47,000)	(\$47,000)	(\$47,000)

### Operational Improvement Savings

These savings are projected to result from managed competition initiatives. The experience of other jurisdictions suggests that time is required before savings accrue.

Unallocated Item	FY 2002	FY 2003	FY 2004
Operational Improvement Savings	(\$10,000)	(\$15,000)	(\$20,000)

Having assessed the detailed assumptions that drive the financial plan's expenditure projections, this discussion now turns to an examination of how these spending projections interact to form aggregate growth rates.

### Aggregate Growth Rate

Through a series of database computations, the growth assumptions described above are applied to the detailed FY 2001 budget to produce spending projections for future years. These projections are then summarized to produce the Financial Plan. The purpose of this discussion is to identify how the interaction of the detailed projections affects the aggregate growth rate. This discussion will focus on the Local Funds version of the financial plan, given that this version best presents the decisions made by the Districts' leadership.

Perhaps the most interesting exercise in reviewing growth rates involves the comparison between regular expenditures, unique expenditures, and total expenditures. Often, the question arises as to why growth rates for total expenditures appear to be irregular over the period of the financial plan, as shown in the table below.

Local Funds Revenues and Expenditures FY 2001 - FY 2004 (\$000)								
	FY 2001 Budget	FY 2002 Forecast		FY 2003 Forecast		FY 2004 Forecast		Average Growth
<b>Revenues</b>	3,195,979	3,235,544	1.2%	3,340,836	3.3%	3,413,314	2.2%	2.2%
<b>Expenditures</b>								
Regular	2,711,049	2,775,298	2.4%	2,868,671	3.4%	2,967,503	3.4%	3.1%
Unique and Unallocated *	484,419	455,260	-6.0%	462,777	1.7%	443,117	-4.2%	-2.9%
<b>TOTAL</b>	<u>3,195,468</u>	<u>3,230,558</u>	1.1%	<u>3,331,448</u>	3.1%	<u>3,410,620</u>	2.4%	2.2%
<b>Annual Surplus</b>	511	4,986		9,388		2,694		
<b>Fund Balance</b>								
Beginning of Year	<u>391,755</u>	<u>392,266</u>		<u>397,253</u>		<u>406,641</u>		
End of Year	<u>392,755</u>	<u>397,253</u>		<u>406,641</u>		<u>409,333</u>		

The answer to this question is revealed by showing the disaggregated growth of regular and unique expenditures. This computation shows that regular expenditures grow at an average rate of 3.1 percent. This rate of growth is intuitive, considering that (a) personal services compose a large portion of the budget and grows at 4.3 percent, and (b) categories that grow more aggressively, like Medicaid (4%) and mass transit (4%) are offset by other items that grow more slowly, such as non-personal services (1.8%) and schools (2.8%).

Unlike regular expenditures, however, unique expenditures grow erratically, reflecting the irregular nature of these items. For the three years projected, these expenditures decline, due to the fact that the mostly reflect savings (which are shown as negative expenditures). Once these rates are added to those of regular expenditures to form total growth rates, the interaction creates changing rates from year to year that— in the absence of this analysis— would suggest great inconsistencies in the projection methodology.

Having shown disaggregated expenditures, however, it now becomes clear that projected expenditures grow rationally and consistently in the Financial Plan.

### THE BOTTOM LINE

As the Congress reviews this budget, the Financial Plan should reveal that the District has produced decisions that effectively balance the need to invest with the need to exercise fiscal discipline. Even with a requirement to budget a \$150 million reserve, the District will improve service delivery, invest in infrastructure, and begin providing tax relief. Furthermore, this plan is not contingent on additional support from the federal government. Instead, it reflects the true commitment and ability of the District's elected leadership to manage responsibly, and reassume home rule.